IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re Enron Corporation Securities Litigation	
MARK NEWBY, Plaintiff	
vs.	CONSOLIDATED LEAD NO. H-01-3624
ENRON CORP., *et al.* Defendants.	
AMERICAN NATIONAL INSURANCE COMPANY, *et al.*, Plaintiffs	
vs.	CIVIL ACTION NO. G-02-0084
ARTHUR ANDERSEN, L.L.P., *et al.*, Defendants.	

MEMORANDUM and ORDER

Pending before the Court is American National Insurance Company, *et al.*'s Emergency Motion for Temporary Injunction and Request for Hearing (Document No. 422) and Lead Plaintiff's *Ex Parte* Application for a Temporary Restraining Order and Order to Show Cause Re: Preliminary Injunction to Enjoin Defendant Andersen's Breakup. (Document No. 440). After reviewing the record and the applicable law, the Court concludes that the motions should be **DENIED**.

Citing a number of newspaper articles, American National Insurance Company, *et al.* ("American") and Regents of the University of California ("Regents") assert that Arthur Andersen, L.L.P. ("Andersen") is in the process of pruning its overseas affiliates and facilitating the departure

of its domestic partners and employees. American and Regents argue that the breakup of Andersen will cause the dissolution of important assets upon which Plaintiffs would base recovery in the above-referenced actions. Consequently, American "asks the Court to enjoin the transfer, release or assignment of Andersen assets to foreign Andersen affiliates and enjoin Andersen's release of any its partners from obligations under non-compete agreements, without express Court approval. (Document No. 422). In a separate motion, Regents asks the Court to grant:

> (1) a temporary restraining order preserving the *status quo* of defendants Andersen L.L.P., Andersen Worldwide Société Coopérative, Switzerland ("Andersen S.C."), and Andersen's member firms and affiliates (collectively, "Andersen") and enjoining Andersen's efforts to dissolve or spin-off divisions or businesses; and (2) an Order to Show Cause why a preliminary injunction should not issue. An order granting injunctive relief is necessary to ensure Andersen can satisfy a probable judgment rendered against it arising from the Enron securities fraud litigation.

(Document No. 440).

The burden in a motion for preliminary injunction rests on the movant. "A preliminary injunction is considered an extraordinary and drastic remedy, not to be granted routinely, but only when the movant, by a clear showing, carries the burden of persuasion." *Evergreen Presbyterian Ministries, Inc. v. Hood*, 235 F.3d 908, 917 (5th Cir. 2000); *see also Okpalobi v. Foster*, 190 F.3d 337, 342 (5th Cir. 1999), *Duncanville Independent School Dist. v. Kendrick*, 994 F.2d 160, 163 (5th Cir. 1993).

The Court's jurisdiction to provide equitable relief, such as injunctions, is limited. In *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc*, the Supreme Court held that a district court does not have the authority to issue an injunction preventing a defendant from transferring assets in which no lien or equitable interest is claimed. 527 U.S. 308 (1999). In *Grupo*, an investor group purchased $75 million in notes issued by Grupo Mexicano, a Mexican holding company. A

few years later, Grupo began having serious financial difficulties. Eventually the investor group accelerated the principal amount of the notes and, a day later, filed suit in the Southern District of New York. Alliance's complaint alleged that Grupo "'is at risk of insolvency, if not insolvent already' and was dissipating its most significant asset . . ." *Id.* at 312. Alliance requested the Court to enjoin Grupo from transferring its most important assets to protect Alliance's ability to recover breach-of-contract damages in the amount of $80.9 million. *Id.* The district court granted the injunction and the Second Circuit affirmed.

The Supreme Court, reversed, holding that the issuance of an injunction was beyond the equitable power of the district court. The Court reasoned that the scope of a federal court's equitable power was frozen in the 18th century by the Judiciary Act of 1789 which gave federal courts jurisdiction over "all suits . . . in equity." *Grupo*, 527 U.S. at 318. In practice, Courts interpret the scope of their equitable power by determining whether the power would have been exercised " by the English Court of Chancery at the time of the separation of the two countries." *Id.* at 318 (quoting *Atlas Life Ins. Co. v. W.I. Southern, Inc.*, 306 U.S. 563, 568 (1939)).

Looking to the historical use of equitable powers, the Court concluded that no authority existed to enjoin an entity from exercising control over its assets prior to entry of a judgment. The court referred to the historical concept that "an unsecured creditor has no rights at law or in equity in the property of his debtor" prior to entry of a judgment. *Grupo*, 527 U.S. at 330. One treatise, quoted by the court, stated:

> A rule of procedure which alllowed any prowling creditor, before his claim was definitely established by judgment, and without reference to the character of his demand, to file a bill to discover assets, or to impeach transfers, or interfere with business affairs of the alleged debtor, would manifestly be susceptible of the grossest abuse. A more powerful weapon of oppression could not be placed at the disposal of unscrupulous litigants.

Id. (quoting *Wait, Fraudulent Conveyances* § 73, at 110-111).

In reaching its holding, the Court distinguished two cases which allowed injunctions to preserve an entity's assets. In *Deckert v. Independence Shares Corp.*, purchasers sued under the Securities Act of 1933, alleging the fraudulent sale of certificates. 311 U.S. 282 (1940). The remedy sought by the purchasers was recision of the contract and restitution of the consideration given. *See Grupo*, 527 U.S. at 325. Immediately, before the court could address their claim under the Securities Act, purchasers requested that the court enter an injunction preventing the company from transferring any assets, citing evidence that the company was on the point of insolvency and in the process of liquidating its holdings. *Id.* The Supreme Court held that entry of an injunction was proper because the complaint stated a cause of action for equitable relief, recision and restitution. In *Grupo* the Court explained that the result would have been different if the purchasers sought only legal relief. *Id.* at 325. In other words, preliminary equitable relief, such as an injunction, is permitted if the final relief sought is equitable. However, if the only relief sought is legal in nature, such as damages or the collection of a debt, equitable preliminary relief is not available. *Id.*

In *United States v. First Nat. City Bank*, the government, in a suit to enforce a tax assessment lien, requested a preliminary injunction to prevent the taxpayer's assets from being transferred by a third-party bank before enforcement. 379 U.S. 378 (1965). The court held that the injunction was appropriate because Congress specifically gave "district courts the power to grant injunctions necessary and appropriate for the enforcement of the internal revenue laws." *Group*, 527 U.S. at 325 (internal quotations and citations omitted). The *Grupo* Court emphasized that the relevant factor in *First National* was not the general equitable powers of the court under the judiciary act, but rather the statutory authority to enter preliminary injunctions in tax cases. *Id.* at 326.

Therefore, the Supreme Court's holding in *Grupo* establishes that, absent a statutory grant of authority, a district court may not grant a preliminary equitable remedy in an action at law. In other words, equitable devices may not be used by a court exercising jurisdiction at law.

The relief sought by American is entirely legal. The original petition filed by American on December 27, 2001 in the 56th Judicial District of Galveston County, Texas, American's prayer for relief seeks:

a. All actual, consequential, and special damages;
b. Prejudgment interest as provided by law;
c. Punitive damages as provided by statutory and common law;
d. Attorneys fees and legal expenses (including expert fees);
e. Post judgment interest; and
d. Costs of court.

(Defs.' Notice of Removal, Tab 2, p. 22). None of the requested forms of relief are equitable in nature. Furthermore, American does not allege that the causes of action upon which it bases its claim specifically authorize equitable remedies. Therefore, American is requesting the Court to exercise equitable jurisdiction in a case at law. The Supreme Court's holding in *Grupo* makes clear that, in such circumstances, the Court does not have the authority to grant equitable forms of relief such as a temporary injunction.

In contrast, Regents complaint does seek equitable forms of relief: recision and restitution. In *Grupo* the Supreme Court approvingly cited the Court's holding in *Deckert* that an action for recision and restitution is an action in equity. *See Grupo*, 527 U.S. at 325; *Deckert*, 311 U.S. 282. Therefore, the Court has jurisdiction to consider Regents' request for a preliminary injunction.

However, to obtain a preliminary injunction, Regents bears the burden of demonstrating that, absent the injunction, it is likely to suffer a substantial and irreparable injury. *Women's Med. Ctr. v. Bell*, 248 F.3d 411, 419 n. 15 (5th Cir. 2001). Regents argues that the possible dissolution of

Andersen creates a "substantial likelihood [it] will not be afforded an effective right of recovery under the federal securities laws." (Document No. 440, p. 15). In support of its assertion, Regents cites *Walczak v. EPL Prolong, Inc.*, in which an injunction was entered to prevent the liquidation and distribution of a company's assets. 198 F.3d 725 (9th Cir. 1999). The irreparable injury in *Walczak* arose out of the likelihood that the plans to dissolve the defendant company would diminish plaintiff's chances of recovering damages, therefore an injunction was appropriate.

The Court concludes, however, that dissolution by itself is not necessarily evidence of irreparable injury. In the present case, Andersen's efforts to dissolve and downsize appear to be designed to preserve, not diminish, resources from which plaintiffs may recover. The press releases and news articles submitted by Regents demonstrate that over the past several months Andersen has lost a large number of clients. Consequently, Andersen currently has more accountants than it has work, or, in other words, more costs than it has revenue. Considering its present situation, Andersen is faced with little choice but to scale back operations in proportion to its diminished client base. Given the urgent need to scale back operations, an injunction would have the effect of delaying the reduction of costs, thereby magnifying the consequences of the erosion in the client base. An affidavit filed by Alvarez & Marsal, Inc., a consultant hired by Andersen to help bring its operations in line with its diminished business, states that "time is of the essence in our efforts. The longer the downsizing process takes, the greater the cash drain and loss of overall value . . . Moreover, the longer Andersen LLP takes to complete the necessary transactions, the greater the possibility that its partners and other employees could decide to leave the firm or find new employment outside the structure of our process." (Document No. 534, p. 4).

At oral argument, counsel for Regents suggested that instead of a prohibition on Andersen's

continued dissolution, it would be satisfied with requiring Andersen to seek the Court's approval with respect to specific steps in the dissolution. However, Regents does not present the Court with any evidence that the downsizing efforts of Andersen, to date, have been designed to prevent plaintiffs from recovering. Rather, the record suggests that Andersen is downsizing in order to salvage as much as possible. Therefore, without evidence of wrongdoing or bad faith, the Court is reluctant to inject itself into Andersen's business decisions. Andersen's ability to quickly and efficiently scale back operations is essential to finding work for its legions of employees and to preserving assets from which plaintiffs may recover.

The Court concludes therefore, that American's motion for preliminary injunction must be denied because, according to *Grupo*, a district court is not permitted to enter an injunction in an action at law. Regent's motion must be denied because, while it arguably may seek a preliminary equitable remedy, the Court concludes that Regents has not carried its burden of persuasion with respect to the irreparable injury requirement of preliminary injunctions. The evidence presented by Regents indicates that Andersen is engaged in a legitimate effort to mitigate the losses suffered by its client exodus. Moreover, the Court declines to require Andersen to seek approval for specific downsizing plans absent evidence that Andersen is acting in bad faith to prevent plaintiff's from recovering.

Accordingly, the Court

ORDERS that American's Emergency Motion for Temporary Injunction is **DENIED**. The Court further

ORDERS that Lead Plaintiff's Application for a Temporary Restraining Order and Order to Show Cause Re: Preliminary Injunction to Enjoin Defendant Andersen's Breakup is **DENIED**.

SIGNED at Houston, Texas, this 16th day of May, 2002.

Melinda Harmon

MELINDA HARMON
UNITED STATES DISTRICT JUDGE